No. 10,085

IN THE

United States Circuit Court of Appeals

For the Ninth Circuit

GLADYS M. SHORES and HAROLD M. F. BEHNEMAN,

Appellants,

vs.

HENDY REALIZATION CO., a corporation (formerly the Joshua Hendy Iron Works), A. J. MAYMAN, C. B. MOORES, E. PRICE, A. E. WEBBER and W. R. BASSICK, individually and as the Directors of Hendy Realization Co., ELMER M. HYLAND and MORRIS LEVIT,

Appellees.

BRIEF FOR APPELLANTS.

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PERNAU-WALSH PRINTING CO., SAN FRANCISCO

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JURISDICTIONAL STATEMENT.

This is an appeal from a final judgment of the United States District Court for the Northern District of California, Southern Division, hereafter referred to as the "District Court", made and entered in the above entitled consolidated causes on November 15, 1941 in favor of defendants and petitioners, appellees herein, and against plaintiff and respondent,

Gladys M. Shores, and respondent, Harold M. F. Behneman, appellants herein. Appellants contend, first, that said District Court was, and is, without jurisdiction over the entire subject matter and issues involved and presented in said consolidated causes; and, second, that said District Court erred in its decision on the merits.

The Shores action.

The cause entitled "Gladys M. Shores, Plaintiff vs. Hendy Realization Co., a corporation, (formerly The Joshua Hendy Iron Works), et al., Defendants" is a stockholder's representative suit in equity for declaratory, injunctive and other equitable relief. This cause, which is hereafter referred to as the "Shores action", was originally commenced in the Superior Court of the State of California, in and for the City and County of San Francisco, hereafter referred to as the "State Court". The complaint in this action (Transcript, page 3) reveals the following facts:

On or about March 4, 1935 certain of the creditors of The Joshua Hendy Iron Works (whose name was later changed to Hendy Realization Co.), a California corporation, hereafter for convenience referred to as the "Hendy Co.", petitioned the District Court for the corporate reorganization of said company under the provisions of former Section 77-B of the National Bankruptcy Act. (*U. S. C.* Title 11, former Section 207.) The proceedings thus initiated resulted in the approval and confirmation of a plan of reorganization, hereafter referred to as the "Plan", by order of the

District Court made on March 24, 1936 (Transcript, page 201), and said Plan was thereupon carried into effect. Under the provisions of said Plan the then outstanding obligations of the Hendy Co. were reduced in amount and deferred as to payment for a period of five years, the obligations thus reduced aggregating approximately $550,000; Paragraph 6G of this Plan provided that, in consideration of said reduction in creditors' claims and the five year extension as to payment thereof, the Hendy Co. stockholders were to deposit their shares with the company's Board of Directors; 50% of the shares so deposited were to be held in trust for five years and thereafter until the reduced and extended obligations of the Hendy Co. had been fully paid, the same then to be redelivered to said stockholders. The remaining 50% of the shares so deposited were to be held by the Board, free and clear of any claim, right, title or interest therein by the depositing stockholders, the same to be distributed by said Board, in its sole discretion, either in whole or in part, to the managing officers of the Hendy Co. "as a reward for management and the successful rehabilitation of the company's affairs". At the time of confirmation of the Hendy Plan, appellant Shores was the owner of 607 shares of Hendy Co. stock, and pursuant to said Plan she deposited her said shares with the individual appellees, Mayman, Moores, Price and Bassick, and A. E. Webber (now deceased), as the Directors of the Hendy Co., and received in return a Voting Trustee's Receipt and Certificate evidencing her ownership of 303½ shares, that is to say, 50% of her original holdings.

Since its incorporation in 1906, the Hendy Co. had been continuously engaged in the general foundry and metal products manufacturing business, with the production department thereof being conducted entirely at the manufacturing plant of the company at Sunnyvale, California. This Sunnyvale plant and the equipment therein represented the principal and all operating assets of the Hendy Co. On November 15, 1940 the said Sunnyvale plant and equipment of the Hendy Co. was sold to MacDonald & Kahn, Inc. for in excess of $400,000, and the continuation of the Hendy Co. in its said business was thereby rendered impossible. At the time of the sale of its said plant and equipment, the Hendy Co. was still obligated for more than $200,000 of the approximately $550,000 of reduced and deferred obligations covered by its Plan of Reorganization. Subsequent to said sale, the said unpaid reduced and deferred obligations were paid in full, and it is alleged that such payment was made possible only through resort to the moneys derived from the sale of the company's capital assets, that is to say, its Sunnyvale plant and equipment.

Shortly prior to December 20, 1940, individual appellees Mayman, Moores, Price and Bassick, together with said A. E. Webber, as the Board of Directors of the Hendy Co. and allegedly acting pursuant to Paragraph 6G 2 of its said Plan, proceeded to distribute to appellees Bassick, Hyland and Levit, as the managing officers of the Hendy Co., all stock previously held by said Directors under Paragraph 6G 2 of the Plan, that is to say, stock representing 50% of the shares of the company outstanding on March 24, 1936 (the date

of confirmation of the Plan) and surrendered to the said Directors of the Hendy Co. by appellant Shores and the other stockholders of the company pursuant to Paragraph 6G of said Plan. On December 20, 1940 proceedings for the winding up and dissolution of the Hendy Co. were commenced, and on December 21, 1940 said Board of Directors proceeded to terminate the Voting Trust created by Paragraph 6G of the Plan and to declare a first liquidating dividend of $45 per share in favor of appellant Shores and the other holders of the then outstanding Trustee's Receipts and Certificates of the Hendy Co. issued pursuant to Paragraph 6G 1 of the Plan. Appellees Bassick, Hyland and Levit, as the distributees of the stock previously held under Paragraph 6G 2 of the Plan, were specifically excluded from participation in this first liquidating dividend.

The complaint further alleges it to be the contention of appellees Mayman, Moores, Price and Bassick, and the said A. E. Webber, as the Directors of the Hendy Co., that, by reason of the allegations of fact mentioned above, the affairs of the Hendy Co. had been *successfully rehabilitated* on November 15, 1940, that is to say, that the sale of the Hendy Co.'s sole operating assets on the last mentioned date, under the circumstances above mentioned, constituted *successful rehabilitation* within the meaning of Paragraph 6G 2 of the Hendy Plan and, accordingly, that the distribution to appellees Bassick, Hyland and Levit, as the managing officers of the Hendy Co., of 50% of the stock deposited by the Hendy stockholders under Paragraph 6G of the Plan was fully justified, thus

entitling said last mentioned appellees to receive future liquidating dividends to be declared by the Hendy Co. upon an equal pro rata basis with appellant Shores and the other stockholders of the Hendy Co. On the other hand, the complaint alleges plaintiff Shores' contention to be that the term *successful rehabilitation,* as used in Paragraph 6G 2 of said Plan, contemplated full payment of the reduced and deferred obligations covered by said Plan *out of earnings of the Hendy Co. derived from the operation of its business as a going concern,* to the end that the capital assets thereof might be preserved for the benefit of its stockholders and the control and management of the company as a going concern ultimately returned to said stockholders; and that the term *successful rehabilitation* did not contemplate payment of the reduced and deferred obligations covered by the Plan out of proceeds of the sale of all operating capital assets and the corporate name and good will of the Hendy Co., followed by a winding up and dissolution of said company.

In the complaint it is alleged that no demand was made by appellant Shores upon appellee Hendy Realization Co. to bring said action, for the reason that the individual appellees Mayman, Moores, Price and Bassick, together with A. E. Webber, constituted the entire Board of Directors of said company and, together with appellees Hyland and Levit, were the persons against whom relief was sought, and that the making of such demand upon said appellee Directors would have been a useless and idle act; that appellee Hendy Co. had accordingly been named as a party de-

fendant in said action, and that the same was brought for and on behalf of said company and all of its stockholders other than appellees Bassick, Hyland and Levit as the holders of the shares of Hendy stock distributed to them in the manner and under the circumstances described in the complaint.

Under the prayer of this complaint, appellant Shores sought a declaration and determination of the rights and duties of the parties to said action with respect to each other under Paragraph 6G of the Hendy Plan; a declaration and determination of the rights and duties of the parties thereto with respect to disposition of the Hendy shares distributed to appellees Bassick, Hyland and Levit under the circumstances above described; and a declaration and determination of the rights and duties of the parties to said action with respect to the future disposition of all liquidating dividends subsequently declared by the Hendy Co. to its stockholders, particularly with reference to whether any such liquidating dividends should be paid on said stock distributed to appellees Bassick, Hyland and Levit, or whether payment of such future liquidating dividends should be restricted to the stockholders of the company whose shares were subjected to the Voting Trust created by Paragraph 6G 1 of the Hendy Plan; that the individual appellees be required to account for all shares of Hendy stock distributed to appellees Bassick, Hyland and Levit in the manner described in said complaint, and that all appellees be enjoined from paying from the assets of the Hendy Co. any liquidating or other dividends on Hendy shares distributed to appellees Bassick, Hyland and

Levit in the manner described in said complaint; that such stock distribution be declared illegal and void, and that appellees Bassick, Hyland and Levit be required to surrender to the Hendy Co. all shares so distributed to them, the same to be cancelled and retired to the treasury of the company.

The Shores action was removed from the State Court where it was originally commenced to the District Court on the petition of appellees. In their removal petition (Transcript, page 31 at 33, 34) the sole ground of removal urged by appellees was that "said suit is one arising out of the laws of the United States in that it involves a Federal question, to wit: the validity, effect and enforcement of the decree of said United States District Court * * * approving and confirming the Plan of Reorganization of The Joshua Hendy Iron Works (a corporation), Debtor, and ordering said reorganization of said debtor in accordance with the provisions of said Plan of Reorganization * * *" Appellant Shores thereupon moved the District Court to remand this action to the State Court, and in her motion to remand (Transcript, page 45) denied appellees' right to removal upon this ground, contending that the Shores action does not involve either the validity, effect or enforcement of the order of the District Court which originally confirmed the Hendy Plan, as urged in appellees' removal petition (Transcript, pages 31, 33), or the construction of the provisions of former Section 77-B of the National Bankruptcy Act under which the Plan was approved; in short, that no "federal question" is pre-

sented by this action. This motion to remand was subsequently denied. (Transcript, page 47.)

The Hendy reorganization proceedings.

The cause entitled "Hendy Realization Co. (formerly The Joshua Hendy Iron Works), a corporation, A. J. Mayman, C. B. Moores, E. H. Price, W. R. Bassick, E. M. Hyland and Morris Levit, Petitioners v. Harold M. F. Behneman and Gladys M. Shores, Respondents" arises out of the above mentioned corporate reorganization proceedings involving the Hendy Co. entitled "In the Matter of The Joshua Hendy Iron Works, a corporation, Debtor", and in connection with which the Hendy Plan was approved and carried into effect. This cause will hereafter be referred to as the "Hendy reorganization proceeding". As previously stated, this proceeding was originally commenced in the District Court on or about March 4, 1935, and the Plan was approved and confirmed by order of the District Court dated March 24, 1936. (Transcript, page 201.) On January 27, 1937 an order denominated "Final Decree Approving and Confirming Report of Execution and Accomplishment of Confirmed Plan of Reorganization: Settling, Approving, and Confirming Final Report and Account of Trustee for Debtor: Settling and Allowing Claims, Fees, and Expenses: Discharging Trustee for Debtor: and Terminating and Closing Reorganization Proceedings" (hereafter referred to as the "final decree") was entered by the District Court in the Hendy reorganization proceeding (Transcript, page 225), in which it was determined that the Hendy Plan had

been fully consummated and carried into effect. *There was no reservation of jurisdiction provided for by the court in said final decree with respect to any matter involved in the Plan, or with respect to any order of the court pertaining thereto.* (See Paragraph 16, Transcript, page 231.) Following entry of the final decree, no further proceedings were taken or had in the District Court in connection with the Hendy reorganization proceeding (see Certificate of clerk of the District Court, Transcript, page 152) until February 19, 1941, when there was filed in the District Court by appellees, without previous application or order permitting intervention, a petition denominated "Petition for Order Aiding, Enforcing, Effectuating and Protecting the Adjudication, Order, and Decree of the Above Entitled Court Confirming Plan of Reorganization and Directing Reorganization of Debtor Pursuant Thereto, and Preventing and Enjoining the Threatened Interference with and Defeat of Said Adjudication, Order, and Decree and the Jurisdiction of the Above Entitled Court" (Transcript, page 233), which petition (hereafter referred to as "appellees' petition of February 19, 1941") was captioned "In the Matter of The Joshua Hendy Iron Works (whose name has been changed to Hendy Realization Co.), a corporation, Debtor", followed by "Hendy Realization Co. (formerly The Joshua Hendy Iron Works), a corporation, et al., Petitioners v. Harold M. F. Behneman and Gladys M. Shores, Respondents". This petition was numbered 25937-S, the number identifying the old Hendy reorganization proceeding. *No process was issued upon the filing of this petition, and*

no diversity of citizenship between the parties is therein alleged. In appellees' petition of February 19, 1941, which really initiated a new action under the guise of the old Hendy reorganization proceeding, it is alleged that the Shores action then pending in the State Court, as well as an identical companion action previously commenced by appellant Behneman entitled "Harold M. F. Behneman, Plaintiff, v. Hendy Realization Co., a corporation (formerly The Joshua Hendy Iron Works), A. J. Mayman, C. B. Moores, E. Price, A. E. Webber and W. R. Bassick, individually and as the Directors of Hendy Realization Co., Elmer M. Hyland and Morris Levit, Defendants", likewise then pending in the State Court (for complaint in this action see Transcript, page 338), constitute an unwarranted and improper attack upon, and an attempted interference with, the order and decree of the District Court of March 24, 1936, which approved and confirmed the Hendy Plan. Through this petition, appellees requested the District Court to permanently enjoin the further prosecution of the Shores and Behneman actions in the State Court.

On March 11, 1941 a second petition denominated "Appellees' Petition for Order Restraining and Staying Pending Actions" (hereafter referred to as "appellees' petition of March 11, 1941") was similarly filed by appellees in the old Hendy reorganization proceeding. This petition (Transcript, page 286), in addition to reaffirming the allegations of appellees' petition of February 19, 1941, also refers to another action commenced by appellant Behneman in the State Court entitled "In the Matter of the Voluntary Wind-

ing Up and Dissolution of Hendy Realization Co., a corporation'' (for complaint in this action see Transcript, page 368), through which appellant Behneman sought to obtain the supervision of the State Court over all matters pertaining to the winding up and dissolution of the Hendy Co., which was then in progress, pursuant to the provisions of Section 403 of the California Civil Code. In appellees' petition of March 11, 1941 they again pray that the further prosecution of the above described Behneman and Shores actions in the State Court be permanently enjoined, and, in addition, that further prosecution of appellant Behneman's action for State Court supervision over the winding up and dissolution of the Hendy Co. be likewise permanently enjoined.

On March 11, 1941 the District Court entered an order temporarily restraining the further prosecution of each of the State Court actions above described, and referred appellees' petitions of February 19 and March 11, 1941 to Hon. Burton J. Wyman, as Special Master, for hearing and report. (Transcript, page 281.) On March 17, 1941 appellants filed a motion to dismiss the petitions and to dissolve the temporary injunction (Transcript, page 336), the motion being made on the grounds that (1) neither of said petitions stated a claim against appellants upon which relief could be granted and (2) that said District Court was without jurisdiction over the subject matter covered thereby.

Hearings were thereupon had before the Special Master on appellees' petitions, during which appellants' motion to dismiss the same was argued. Upon

the conclusion of the hearings, the Special Master, on March 28, 1941, filed with the District Court his certificate and report (Transcript, page 293), in which it was found and concluded that the District Court had jurisdiction over the subject matter of appellees' petitions of February 19 and March 11, 1941, and in which it was recommended (1) that the temporary restraining order be continued in effect; (2) that appellants' motion to dismiss be denied; and (3) that appellants be permitted to plead to the petitions and that the same then be heard on the merits. (Transcript, page 334.)

On April 4, 1941 appellants filed their objections to the certificate and report of the Special Master (Transcript, page 371), and upon the argument thereof before the District Court it was ordered that ruling on the same would be reserved until the time of trial, and that this proceeding instituted by appellees within the old Hendy reorganization proceeding and the Shores action (appellants' motion to remand the same to the State Court having by this time been denied—Transcript, page 47) be consolidated for trial. (Transcript, page 49.) An answer was thereupon filed by appellees to the complaint in the Shores Action (Transcript, page 51), and an answer and counterclaim was filed by appellants to appellees' February 19 and March 11, 1941 petitions in the Hendy reorganization proceeding (Transcript, page 375), the counterclaim alleging in substance all matters set forth in the Shores complaint. Appellees' answer to the counterclaim was then filed (Transcript, page 403), and the consolidated causes thus brought to issue. The

ensuing trial resulted in entry of judgment in favor of appellees and against appellants in both causes. (Transcript, page 131.)

Upon the foregoing statement of pleadings and facts, and for the reasons hereafter set forth in this brief, appellants contend that *the District Court was without jurisdiction over the subject matter involved in either of the consolidated causes.*

The appellate jurisdiction of the Circuit Court of Appeals in these consolidated causes is based upon the following statutory provisions:

> "The Circuit Courts of Appeals shall have appellate jurisdiction to review by appeal final decisions:
>
> First: In the District Courts, in all cases save where a direct review of the decision may be had in the Supreme Court under Sec. 345 of this title."
>
> *Judicial Code,* Sec. 128;
>
> *U. S. C.,* Title 28, Sec. 225.

No direct review of the decision of the District Court in this case may be had to the Supreme Court under the section referred to in the statutory provision quoted above.

Rule 73(a) of the *Rules of Civil Procedure for the District Courts of the United States* provides in part:

> "When an appeal is permitted by law from a District Court to a Circuit Court of Appeals and within the time prescribed, a party may appeal from a judgment by filing with the District Court a notice of appeal."

The District Court entered final judgment in these consolidated causes (Transcript, page 131) in favor of appellees and against appellants on November 15, 1941. This judgment is within the meaning of the above quoted jurisdictional statute, thus making the judgment subject to review on appeal in this court. Appellants' notice of appeal from the final judgment was filed in the District Court on December 15, 1941. (Transcript, page 136.)

STATEMENT OF THE CASE.

Through this appeal appellants have attacked the propriety of the final judgment entered in the District Court in these consolidated causes on two principal grounds, namely:

First: That the District Court was without jurisdiction over the subject matter and issues presented in said causes;

Second: That the District Court erred in its decision on the merits.

Neither the pleadings nor the evidence show any substantial conflict as to the facts to be considered by the court in passing on each of these points, and those facts have already been set forth and described in detail in this brief under the Jurisdictional Statement.

The jurisdictional questions are raised through retention of jurisdiction by the District Court over the Shores action following denial of appellant Shores' motion to remand this action to the State Court, and

by reason of denial in the final judgment of appellants' motion to dismiss the February 19 and March 11, 1941, petitions filed by appellees in the Hendy reorganization proceeding.

The questions regarding the propriety of the final judgment on the merits are raised by reason of the ruling of the District Court that on and prior to December 20, 1940, the affairs of the Hendy Co. had been *successfully rehabilitated* within the meaning of that term as used in Paragraph 6G 2 of the Hendy Plan of Reorganization, thus permitting appellees Bassick, Hyland and Levit to retain the 2212½ shares of Hendy stock distributed to them by the Hendy Directors on said last mentioned date. It is accordingly appropriate that Paragraph 6G of the Plan be set forth in full here. Said Paragraph reads as follows:

> "G. Capital stock.
>
> 4425 shares of the capital stock of the debtor corporation are now outstanding, said shares having a book value of $212,898.51, but no actual value.
>
> In consideration of the extensions granted by the creditors and of the reduction of their claims in the sum of $73,853.06, as aforesaid, the stockholders shall appropriately endorse and deliver the stock held by them to the Board of Directors of the debtor corporation, appointed as hereinafter provided, to be held by said Board as follows:
>
> 1. 50% of the shares so deposited by each stockholder shall be held in trust and voted by said Board for a period of 5 years, and thereafter until the extended obligations are fully

paid, so as to leave the management of the debtor corporation during such period in the hands of its creditors. The Board shall have full power to vote said stock, including the power to vote for a reorganization of the capital structure of the debtor corporation so as to provide, at any time, for an issue of one or more classes of preferred stock and the exchange therefor of any part or all of the unsecured liabilities of the debtor corporation. Upon the expiration of 5 years and the payment in full of the extended obligations, such shares shall be returned to their respective owners.

2. The remaining 50% of the shares so delivered by each stockholder shall be held by said Board free and clear of any claim, right, title, or interest therein by such stockholder, to be distributed by said Board, in its sole discretion, either in whole or in part, to the managing officers thereof, as a reward for management and the successful rehabilitation of the company's affairs." (Transcript, pages 186, 187.)

As stated above, the pertinent facts necessary to a consideration of all of these questions by this court have been set forth in the jurisdictional statement of this brief, and in the interests of brevity will not be repeated here.

SPECIFICATION OF ERRORS RELIED UPON BY APPELLANTS.

I. The District Court erred in making and entering the final judgment herein on November 15, 1941, for the reason that it was without jurisdiction over the subject matter involved in the above entitled consolidated causes, or either of them. This specification of error is also directed at Consolidated Finding of Fact No. XXII (Transcript, page 124) and Consolidated Conclusion of Law No. 1 (Transcript, page 127) wherein the District Court finds and concludes as a matter of law that its jurisdiction over the subject matter of these consolidated causes is sole and exclusive.

II. The District Court erred in denying the motion of appellants Shores and Behneman to dismiss, for want of jurisdiction over the subject matter, appellees' petitions filed in the Hendy reorganization proceeding on February 19, 1941 (Transcript, page 233) and on March 11, 1941 (Transcript, page 286), and to vacate the restraining order entered on March 11, 1941 (Transcript, page 290), and accordingly erred in entering its final judgment in these consolidated causes on November 15, 1941. (See Paragraph 2 of judgment, Transcript, page 133.) This specification of error is also directed at Consolidated Finding of Fact No. XXII (Transcript, page 124) and Consolidated Conclusion of Law No. 1 (Transcript, page 127) wherein the District Court finds and concludes as a matter of law that its jurisdiction over the subject matter of these consolidated causes is sole and exclusive.

III. The District Court erred in approving in its said final judgment entered on November 15, 1941, the certificate and report of Hon. Burton J. Wyman, as Special Master, dated March 28, 1941, and in entering said final judgment in favor of appellees in view of the fact that by reason of their failure to properly intervene in said reorganization proceeding, in accordance with Rule 24 of the Rules of Civil Procedure for the District Courts of the United States, said individual appellees are not proper parties thereto. This specification of error formed the basis of objection No. 1 of appellants' objections to said Special Master's certificate and report (Transcript, page 371), which objections were not ruled upon by said District Court until entry of said final judgment on November 15, 1941. (Transcript, page 133.)

IV. The District Court erred in making its order (Transcript, page 47) denying the motion of appellant Shores to remand the Shores action to the Superior Court of the State of California, in and for the City and County of San Francisco (Transcript, page 45) and in entering final judgment in these consolidated causes. Said action is not one arising under the Constitution or laws of the United States, which was the sole ground urged by appellees for removal thereof from said State Court (in which jurisdiction had already attached) to said District Court, and said motion to remand should accordingly have been granted. This specification of error is also directed at Consolidated Finding of Fact No. XXII (Transcript, page 124) and Consolidated Conclusion of Law No. 1 (Transcript, page 127) wherein the District Court

finds and concludes as a matter of law that its jurisdiction over the subject matter of these consolidated causes is sole and exclusive.

V. The District Court erred in finding and concluding as a matter of law that on and prior to both November 15, 1940 and December 20, 1940, the affairs of appellee Hendy Realization Co. had been successfully rehabilitated within the meaning of that term as used in Paragraph 6G 2 of the Hendy Plan of Reorganization, as specified in Finding No. IX (Transcript, page 106) and in Conclusion of Law No. 2 (Transcript, page 127) of the consolidated findings of fact and conclusions of law made and entered herein.

VI. The District Court erred in finding and concluding as a matter of law that appellees Bassick, Hyland and Levit, as the managing officers of appellee Hendy Realization Co., were entitled to the 2212½ shares of capital stock of appellee Hendy Realization Co. distributed to them on December 20, 1940, by appellees Mayman, Moores, Price and Bassick, and by A. E. Webber (now deceased), as the then Directors of appellee Hendy Realization Co., as specified in Finding No. XV (Transcript, page 115) and in Finding No. XVI (Transcript, page 118) and in Conclusion of Law No. 3 (Transcript, page 128) of the consolidated findings of fact and conclusions of law made and entered herein.

VII. The District Court erred in finding and concluding as a matter of law that appellees Bassick, Hyland and Levit, as the managing officers of appellee Hendy Realization Co., had been inadequately com-

pensated for the services rendered by them to said appellee corporation between March 24, 1936 and November 15, 1940, and in finding and concluding as a matter of law that the payment of additional compensation or bonuses by said appellee corporation to appellees Bassick, Hyland and Levit on December 4, 1940, was proper, as specified in Finding No. XI (Transcript, page 108) and in Finding No. XVI (Transcript, page 118) and in Conclusion of Law No. 3 (Transcript, page 128) of the consolidated findings of fact and conclusions of law made and entered herein. These findings of fact and conclusions of law deal with matters not within the fundamental issues raised by the pleadings, and go beyond the scope of the relief prayed for by any party to these consolidated causes.

VIII. The District Court erred in providing in its judgment that appellants should be permanently restrained and enjoined from interfering with, or attacking through court proceedings or otherwise, the additional compensation or bonus payments made by appellee Hendy Realization Co. to appellees Basick, Hyland and Levit on December 4, 1940, as provided in Paragraph No. 4 of the judgment made and entered herein on November 15, 1941. (Transcript, pages 134, 135.) This relief goes beyond the scope of the issues raised by the pleadings, and the granting of the same was accordingly improper.

SUMMARY OF ARGUMENT.

Appellants' argument of this case will be presented under the following headings:

1. The District Court had no jurisdiction over the subject matter involved in the Hendy reorganization proceeding, as presented by appellees' petitions of February 19 and March 11, 1941. This position will be based upon the contention that:

   (a) The Shores State Court action, the companion Behneman State Court action and the Behneman action for State Court supervision over the winning up and dissolution of the Hendy Co. do not seek to interfere with any order or decree of said District Court entered in the Hendy reorganization proceeding, and their prosecution in the State Court should accordingly not have been enjoined;

   (b) The Hendy reorganization proceeding was terminated and closed without reservation of jurisdiction by final decree of the District Court entered therein on January 27, 1937; hence, jurisdiction over appellees' petitions of February 19 and March 11, 1941, should not have been entertained.

2. The individual appellees are not proper parties to the Hendy reorganization proceeding for the reason that none of them have ever properly intervened in said proceeding.

3. The District Court had no jurisdiction over the subject matter involved in the Shores action, as presented by appellant Shores' complaint filed therein.

No "federal" question is presented by the facts alleged in this complaint, and its removal from the State Court, where originally commenced and where jurisdiction had already attached, was therefore improper.

4. The judgment of the District Court on the merits was erroneous.

5. The injunctive relief granted appellees exceeds the issues raised in these consolidated causes.

ARGUMENT.

1. THE DISTRICT COURT HAD NO JURISDICTION OVER THE SUBJECT MATTER INVOLVED IN THE HENDY REORGANIZATION PROCEEDING AS PRESENTED BY APPELLEES' PETITIONS OF FEBRUARY 19 AND MARCH 11, 1941.

Subdivision (h) of former Section 77-B of the National Bankruptcy Act reads, in part, as follows:

> "Upon the termination of the proceedings a final decree shall be entered discharging the trustee or trustees, if any, making such provisions as may be equitable, by way of injunction or otherwise, and closing the case." (*U. S. C.*, Title 11, Sec. 207.)

On January 27, 1937, the District Court entered a final decree in the Hendy reorganization proceeding pursuant to the above quoted subdivision of said Section 77-B. This final decree contained no reservation of jurisdiction whatsoever. On the contrary, it was therein determined that the Hendy plan of Reorganization had been fully consummated and carried into effect, and Paragraph 16 of said final decree provided:

> "That the proceedings for the corporate reorganization of the debtor in this court, entitled 'In the Matter of The Joshua Hendy Iron Works, a corporation, Debtor, No. 25937-S', be, and the same hereby are, terminated and closed; such termination and closing to be for all purposes final upon the filing herein of receipts showing the payment of the final fees and expenses hereinabove allowed, and the surrender and exchange of the stock certificates which have not yet been surrendered and exchanged as provided in said Plan of Reorganization." (Transcript, pages 231, 232.)

No further orders were thereafter made, and no further proceedings of any kind were thereafter had or taken in connection with the Hendy reorganization proceeding until the filing therein of appellees' petition of February 19, 1941, *over four years after entry of said final decree.* Under this petition and their supplemental petition of March 11, 1941, the individual appellees, therein referred to as "Petitioners", seek to restrain appellants Shores and Behneman, therein referred to as "Respondents", from further prosecution of their then pending State Court actions above described. The gist of appellees' February 19 and March 11, 1941, petitions is that the said State Court actions seek to obstruct, attack and interfere with the order and decree of the District Court confirming the Hendy Plan of Reorganization. In this connection, it is significant to note here that said State Court actions affected only the individual appellees and not the rights of either the Hendy Co. or its creditors; and, accordingly, *that the only persons to be*

benefited through the enjoining of further prosecution of these State Court actions were the individual appellees. These facts give rise to two of the jurisdictional questions to be determined on this appeal:

(a) Did the State Court actions initiated by appellants seek to obstruct, attack or interfere with the order and decree of the District Court approving and confirming the Hendy Plan of Reorganization, thus entitling appellees to have the further prosecution of these actions permanently enjoined?

(b) In view of entry of the final decree in the Hendy reorganization proceeding on January 27, 1937, did the District Court have continuing jurisdiction over the subject matter presented in the injunction proceedings instituted by appellees' petitions of February 19 and March 11, 1941?

For the following reasons, appellants' answers to each of these questions are in the negative.

1(a). THE STATE COURT ACTIONS INSTITUTED BY APPELLANTS SHORES AND BEHNEMAN DID NOT SEEK TO OBSTRUCT, ATTACK OR INTERFERE WITH THE ORDER AND DECREE OF THE DISTRICT COURT APPROVING AND CONFIRMING THE HENDY PLAN OF REORGANIZATION.

Discussion of the Shores and Behneman declaratory relief actions.

The character of the Shores and Behneman State Court actions has already been fully described. It will be recalled that under Paragraph 6G 2 of the Hendy Plan it was provided that 50% of the Hendy shares surrendered by each of the old Hendy stockholders to the Hendy Board of Directors was to be held by said

Board "free and clear of any claim, right, title or interest therein by such stockholder, to be distributed by said Board, in its sole discretion, either in whole or in part, to the managing officers thereof, *as a reward for management and the successful rehabilitation of the company's affairs.*" (Italics ours.)

Unfortunately, the Hendy Plan does not define what is meant by the term "successful rehabilitation", or prescribe under what circumstances the affairs of the Hendy Co. would be deemed to have been successfully rehabilitated. Had it done so, the question of whether or not the affairs of this company had been successfully rehabilitated on or about December 20, 1940, when the stock was distributed, could readily have been determined. Such determination would, however, necessarily have depended upon *events occurring after the Plan had been consummated and put into effect*—not before. In the absence of a definition of this term in the Plan, it becomes necessary to consider what all of the parties thereto, that is to say, the Hendy stockholders and creditors, intended it to mean when the Plan was approved by them and confirmed by the District Court. Once the intended meaning of the term is thus established, it likewise then becomes equally necessary to review *events occurring subsequent to consummation of the Plan and to the conclusion of the reorganization proceeding* in order to determine whether successful rehabilitation of the Hendy Co.'s affairs was ever accomplished.

Through the State Court actions brought by appellants on behalf of the Hendy Co. and all of its stockholders against the individual appellees as the Direc-

tors and managing officers of said company appellants seek a judicial determination, i.e., a declaratory judgment, with respect to the property rights of the parties in the stock which, prior to the commencement of said actions, had been distributed to appellees Bassick, Hyland and Levit, as managing officers, under the circumstances described above. In these actions it is contended that, in view of events occurring after the closing of the reorganization proceeding, a successful rehabilitation of the affairs of the Hendy Co. within the meaning of that term as used in the Hendy Plan had not been accomplished, and the State Court is called upon to determine whether this contention is correct. Jurisdiction over the parties to, and the subject matter of, these actions had already attached in the State Court at the time when their further prosecution was enjoined by said District Court. It is appellants' contention that the questions thus presented in these State Court actions could have been, and should have been, determined in the State Court, which court had original and exclusive jurisdiction thereof.

Prosecution of appellants' State Court actions has been permanently enjoined by the District Court on the sole ground that they seek to obstruct, attack and interfere with its order approving and confirming the Hendy Plan of Reorganization. This presents the question: In what way can these State Court actions be said to attack, obstruct or interfere with this order? It is true that through these actions appellants question the interpretation placed on Paragraph 6G 2 of the Hendy Plan *by the appellee Hendy Directors* long after the Plan was carried into effect, and that appel-

lants likewise question the right of said Directors to distribute the Hendy stock in controversy solely upon the basis of *their interpretation* of the meaning of the term "successful rehabilitation of the company's affairs" as used in the Hendy Plan. As pointed out above, neither the Hendy Plan nor any order of the District Court with reference thereto defines the meaning of the term "successful rehabilitation", or prescribes under what circumstances such event will be deemed to have been accomplished. This being true, it cannot be said that appellants' State Court actions attack, obstruct or interfere with anything ordered or prescribed in any order of the District Court pertaining to the Plan. They merely seek a determination of property rights arising out of the Plan, and it will be remembered that the reorganization proceeding had been terminated and closed by final decree approximately four years prior to the filing of these actions.

A "Plan of Reorganization", as the term was used in proceedings under Section 77-B of the Bankruptcy Act, is, after all, merely a contract between the debtor corporation, its creditors and stockholders, whereby the rights of those parties are adjusted in a manner acceptable to them, and once they have agreed in this respect the order of the District Court approving and confirming that agreement merely gives the Plan subsequent legal effect. As stated by Mr. Gerdes (*Gerdes on Corporate Reorganization,* Vol. 2, p. 1664, Sec. 1036):

> "The entire proceeding under this amendment (77-B) has for its sole purpose the preparation of a plan, its approval by the court, and its con-

> summation under the direction of the court * * * Upon confirmation by the court the plan is binding upon all creditors and stockholders of the debtor corporation."

Johnson on Bankruptcy Reorganizations (p. 519, Sec. 603a) characterizes a Plan of Reorganization as follows:

> "A reorganization plan, although formulated according to statutory rules, is similar to a composition arrangement and is therefore simulated to a contract or agreement. While dissenters are bound by the requisite majority accepting the plan, it is in effect an agreement by which, under the law, the minority are bound by the majority. The relation of co-creditors and co-stockholders is recognized, and collective action is coerced. *The rules of construction and interpretation applied to contracts govern in the analysis of a reorganization plan."* (Italics ours.)

Viewing the Hendy Plan as an ordinary contract, the meaning and interpretation of which is not entirely clear in certain particulars, and in connection with which a controversy has arisen between the parties with respect to certain rights established thereby, it certainly cannot be said that a State Court is without power to construe and interpret that contract in accordance with established legal principles governing the construction of contracts. On the other hand, the same conclusion must be reached if the Plan is considered as merged into the order of the District Court confirming it. The order of the District Court approving and confirming the Hendy Plan is a final

judgment, no appeal ever having been taken therefrom. As such, it is no different from any other final judgment. It is fundamental that a judgment creates a contract or obligation between the parties (33 *C. J.* 1056, Judgments, Sec. 9; *Weaver v. City & County of San Francisco,* 146 Cal. 728 at 732), and that a new action may be brought upon a final and subsisting judgment. (15 *Cal. Jur.* 258, Judgments, Sec. 258.) Thus an action on a judgment is an action on a contract, irrespective of the nature of the original transaction on which the judgment is founded. (33 *C. J.* 1057, Judgments, Sec. 9.) Furthermore, an action may be maintained in a state court upon a judgment rendered in a Federal Court. (34 *C. J.* 1160, 1161, Judgments, Sec. 1643; 34 *C. J.* 1104, Judgments, Sec. 1569.)

We do not believe that appellees will or can contend that a state court is without power to construe the language and effect of a final judgment rendered by a Federal court if called upon to do so in an appropriate action based upon such final judgment. The mere fact that a suit in a state court is brought on a judgment recovered in a Federal court does not entitle the defendant to a removal to the Federal court. (*Provident Savings Life Assurance Society of New York v. Ford,* 114 U. S. 635, 29 L. Ed. 261.) For, as pointed out above, a final judgment is a contract, and the interpretation and construction of contracts is within the province of a state court. The legal operation and effect of a judgment must be ascertained by a construction and interpretation of it. This presents a question of law for the court. Judgments

must be construed as a whole, and so as to give effect to every word and part. Where a judgment is susceptible of two interpretations, that one will be adopted which renders it more reasonable, effective and conclusive (34 *C. J.* 501, Judgments, Sec. 794); and it must be remembered that the Shores and Behneman State Court actions were filed pursuant to the California Declaratory Relief Act (Sec. 1060, *Cal. Code of Civil Procedure*), which provides:

> "Any person interested under a deed, will or other written instrument, or under a contract, or who desires a declaration of his rights or duties with respect to another, or in respect to, in, over or upon property, or with respect to the location of the natural channel of a water course, may, in cases of actual controversy relating to the legal rights and duties of the respective parties, bring an action in the superior court for a declaration of his rights and duties in the premises, including a determination of any question of construction or validity arising under such instrument or contract. He may ask for a declaration of rights or duties, either alone or with other relief; and the court may make a binding declaration of such rights or duties, whether or not further relief is or could be claimed at the time. The declaration may be either affirmative or negative in form and effect, and such declaration shall have the force of a final judgment. Such declaration may be had before there has been any breach of the obligation in respect to which said declaration is sought."

Henderson v. Oroville-Wyandotte Irrigation Dist., 207 Cal. 215, is a case in point here. In this case,

plaintiff brought an action for declaratory relief to have his water rights in certain land declared. The California Superior Court in which this action was filed was called upon to construe an order of the California Railroad Commission which had become final. Defendant maintained that such order was reviewable only in the State Supreme Court, and its demurrer to plaintiff's complaint was sustained without leave to amend. In reversing this ruling, the California Supreme Court said that the validity of the order of the Railroad Commission was not in question or under review, but that the interpretation only of that order was before the court. In this connection, the court said (at page 219):

> "Where a written instrument affects the title to real property, otherwise subject to the jurisdiction of the Superior Court, we can conceive of no reason why such an instrument may not be construed and its meaning declared, *even though the document is final in its nature and is the result of action by either the legislative, executive or judicial branches of a state government or the Government of the United States.*" (Italics ours.)

It is submitted that this reasoning is applicable to this case, and that an application to a state court for the determination of property rights growing out of a Plan of Reorganization confirmed by a Federal court in a proceeding which has been finally terminated and closed is not tantamount to an interference with, an attack upon, or an obstruction of the final judgment of such Federal court approving and confirming the Plan, even though, as an incident to grant-

ing the relief sought, the state court is called upon to construe uncertain or ambiguous language contained in such Plan in order to determine the intention of the parties thereto, or to determine the property rights created thereby. Cases such as *Holmes v. Rowe,* 97 Fed. (2d) 537 (C. C. A. 9, 1938); *Local Loan Co. v. Hunt,* 292 U. S. 234, 78 L. Ed. 1230; and *In re Hermitage Bldg. Corp.,* 100 Fed. (2d) 597 (C. C. A. 7, 1938), are not in point, for in each of these cases *an attempt was made to specifically do some act or thing which the court had previously decreed should not be done.* Such is not the case here.

Discussion of the Behneman action for State Court supervision over the winding up and dissolution of the Hendy Co.

The temporary restraining order of the District Court entered in the Hendy reorganization proceeding on March 11, 1941 enjoined not only the further prosecution of the Shores and Behneman State Court declaratory relief actions described and discussed above, but also the further prosecution of the previously referred to State Court action instituted by appellant Behneman on February 25, 1941, entitled "In the Matter of the Voluntary Winding Up and Dissolution of Hendy Realization Co., a corporation". Under the final judgment of the District Court entered in these consolidated proceedings on November 15, 1941, the prosecution of this State Court action has been permanently enjoined upon the express finding "That in and by said actions said respondents moreover seek to have said Superior Court construe and interpret the terms and provisions of said order

dated March 24, 1936, particularly with reference to the distribution of said stock as aforesaid, and seek to have said Superior Court declare and determine the rights and duties of the parties thereunder and the nature, extent, and effect of said order dated March 24, 1936; and that *said actions all grow out of, relate to, and involve the proceedings for the reorganization of Hendy Co., one of the above entitled consolidated causes"* (see Finding No. XXI, Transcript, page 124); and upon the further express finding "That it is true that said respondents, and each of them, threaten to continue and prosecute said actions in said Superior Court unless restrained and enjoined therefrom; that, unless restrained and enjoined from so doing by the above entitled court, respondents and each of them will proceed with the prosecution of said actions and the taking of other actions designed to interfere with and defeat the terms, purpose, and enforcement of said order dated March 24, 1936, and will seek to prevent and nullify the enforcement and effectuation thereof; * * *" (See Finding No. XXIII, Transcript, page 125.)

As will appear from the complaint filed in this State Court action (Transcript, page 368), appellant Behneman, as the owner of more than 5% of the outstanding stock of the Hendy Co., seeks to avail himself of the provisions of Sec. 403 of the *California Civil Code,* which provides for State Court supervision over all matters pertaining to the winding up of the affairs of a California corporation when such corporation is in the process of voluntary winding

up and dissolution. Voluntary dissolution proceedings were admittedly commenced by the Hendy Co. on or about December 20, 1940 (see Stipulation of Counsel, Transcript, pages 569, 570; also Finding No. XVIII; Transcript, page 119), over two months prior to commencement of this Behneman State Court action, and said dissolution proceedings are still pending. Accordingly, this State Court action is *purely statutory* in character and was initiated under a California statute designed to afford a corporate stockholder the relief therein provided for. Such action can have no possible connection with the Hendy reorganization proceeding or the Hendy Plan of Reorganization, and there is no comparable action available to appellant Behneman or any other stockholder of the Hendy Co. in the Federal courts. Therefore, to permanently enjoin further prosecution of this action is to deprive appellant Behneman, as a stockholder of the Henry Co., of an established right guaranteed by State statute. It is submitted that under these circumstances the District Court was without jurisdiction to issue a permanent injunction bringing about this result. The findings referred to and quoted above, insofar as they purport to deal with this particular State Court action, are wholly unsupported by any evidence whatever in the record, and the injunction enjoining its further prosecution should accordingly be dissolved.

1(b). IN VIEW OF ENTRY OF THE FINAL DECREE IN THE HENDY REORGANIZATION PROCEEDING ON JANUARY 27, 1937, DID THE DISTRICT COURT HAVE CONTINUING JURISDICTION OVER THE SUBJECT MATTER PRESENTED IN THE INJUNCTION PROCEEDINGS INSTITUTED BY APPELLEES' PETITION OF FEBRUARY 19 AND MARCH 11, 1941?

This subdivision of this brief raises a question which has not heretofore been the subject of many decisions in the Federal courts. Under the final decree entered in the Hendy reorganization proceeding on January 27, 1937, there was no reservation of jurisdiction whatsoever provided for by the District Court (Transcript, page 225 at 231); and no further proceedings of any kind were thereafter had or taken therein until the filing of appellees' petition of February 19, 1941—over four years after entry of the final decree and the closing of the case. This statement is supported by the certificate of the clerk of said District Court (Transcript, page 152), in which it is stated that "* * * there are included in the accompanying record on appeal all pleadings and orders filed therein subsequent to January 27, 1937, and up to the date of entry of judgment on November 15, 1941, as designated, and that there is no record in my office of any proceedings taken or had in said action, No. 25,937-S, during said period other than as indicated in the accompanying record on appeal". Examination of the record on appeal before this court reveals that from January 27, 1937 until February 19, 1941 *no pleadings or orders were filed, and no proceedings of any kind were taken,* in the Hendy reorganization proceeding, numbered 25,937-S, in said District Court.

It is therefore appellants' contention that through entry of this final decree, without any reservation of

jurisdiction, the District Court lost all power to later entertain jurisdiction over injunction proceedings of the character instituted by appellees' petitions of February 19 and March 11, 1941, and that the old reorganization proceeding, having been definitely and finally closed, could not be revived through the filing of such petitions. This contention is supported by the few available decisions on the subject, namely:

In re Argyle-Lakeshore Bldg. Corp., 98 Fed. (2d) 372 (C. C. A., 7th Cir., June, 1938);

In re Diversey Bldg. Corp., 90 Fed. (2d) 703 (C. C. A., 7th Cir., June, 1937);

In re Corona Radio and Television Corp., 102 Fed. (2d) 959 (C. C. A., 7th Cir., April, 1939);

In re Sherland Bldg. Corp., 29 Fed. Sup. 985 (D. C. N. D. Indiana, November, 1939);

In re Volland, 83 Fed. (2d) 680 (C. C. A., 7th Cir., April, 1936).

The District Court accordingly erred in denying appellants' motion to dismiss appellees' petitions of February 19 and March 11, 1941.

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2. THE INDIVIDUAL APPELLEES ARE NOT PROPER PARTIES TO THE HENDY REORGANIZATION PROCEEDING FOR THE REASON THAT NONE OF THEM HAVE EVER PROPERLY INTERVENED IN SAID PROCEEDING.

In filing their above described petitions of February 19 and March 11, 1941 in the Hendy reorganization proceeding, the individual appellees styled them-

selves as "Petitioners", and it will be remembered that they are the same individuals named as "Defendants" in the Behneman and Shores State Court declaratory relief actions. However, none of the individual appellees had ever previously been "parties" to the reorganization proceeding. Therefore, even assuming (but not conceding) that the reorganization proceeding had not been finally terminated and closed by the final decree entered therein on January 27, 1937, the appellees would necessarily have had to *intervene in the reorganization proceeding in order to become proper parties thereto* and in order to give the District Court jurisdiction to consider the subject matter of their petitioners. It is clear from the record that none of the individual appellees ever had intervened in the reorganization proceeding prior to the filing of these petitions. (See Certificate of the Clerk of the District Court, Transcript, page 152; also items 1 and 2 of appellants' Supplemental Designation of Contents of Record on Appeal filed in the District Court, Transcript, page 147.)

Subdivision (c)(11) of Former Sec. 77-B of the *Bankruptcy Act* (U. S. C. Title 11, Sec. 207), under which the Hendy reorganization proceeding was instituted, provided in part:

> "Any creditor or stockholder shall have the right to be heard on the question of the permanent appointment of any trustee or trustees, and upon the proposed confirmation of any reorganization plan, *and upon filing a petition for leave to intervene, on such other questions arising in the proceeding as the judge shall determine.*" (Italics ours.)

Under the foregoing quotation from former Section 77-B, the right of a party in interest to be heard in a proceeding under that section was definitely *conditioned upon intervention* except as to the appointment of a trustee or as to the confirmation of a reorganization plan. These are the exclusive exceptions (*In re Trust No. 2988 of Foreman Trust & Savings Bank,* 85 Fed. (2d) 942, C. C. A., 7th Cir., 1936), neither of which are involved here.

In 33 *Cor. Jur.* 477, the term "intervention" is defined as:

> "* * * the act or proceeding by which a third party becomes a party in a suit pending between others; * * *"

In re Willacy County Water Control & Imp. Dist. No. 1, 36 Fed. Sup. 36 at 40, defines "intervention" as follows:

> "Intervention is the admission, by leave of the court, of a person not an original party, into the proceeding, by which such person becomes a party thereto for the protection of some right or interest alleged by him to be affected by the proceeding."

Rule 24 of the *Rules of Civil Procedure for the District Courts of the United States* specifically describes the circumstances under which intervention is permitted, and outlines the procedure to be followed with reference thereto. In *Miami County National Bank, etc. v. Bancroft,* 121 Fed. (2d) 921 at 925, 926 (C. C. A., 10th Cir., 1941), in discussing the failure of the Attorney General of Kansas to inter-

vene in certain actions in the Federal District Court to establish heirship, the purpose of Rule 24 is stated to be as follows:

> "Rule 24 of the new Federal Rules, 28 U. S. C. A. following Sec. 723(c) relates to intervention. It provides for both permissive intervention and for intervention as a matter of right. In each instance timely application must be made. Subsection (c) of the Rule provides that one desiring to intervene shall serve a notice upon all parties affected thereby. The motion for intervention must state the grounds therefor and shall be accompanied by a pleading setting forth the claims or defense upon which intervention is sought. No part of this Rule was complied with by the Attorney General * * * No pleading was filed with the application, as required by Rule 24(c). The purpose of the Rule requiring the motion to state the reasons therefor and accompanying the motion with a pleading setting forth the claim or defense is to enable the court to determine whether the applicant has the right to intervene, and, if not, whether permissive intervention should be granted."

Whether the individual appellees in these causes would have been permitted to intervene in the Hendy reorganization proceeding upon a proper application to the District Court is a moot question. The important point here is that *they failed to properly intervene or to take any steps whatsoever in that direction.* Appellants urged this point in arguing before the Special Master their motion to dismiss appellees' petitions of February 19 and March 11, 1941 and

vacate the temporary restraining order based thereon, but in his certificate and report filed with the District Court (Transcript, page 293) following this argument, the Special Master completely ignored this subject. Appellants again raised the same point in their written objections filed in the District Court to the Special Master's certificate and report (see Objection No. 1, Transcript, page 371), but the District Court likewise ignored the same in the findings of fact and conclusions of law upon which its judgment of November 15, 1941 is based.

That the individual appellees could not become proper parties to the Hendy reorganization proceeding by the mere act of filing their petitions of February 19 and March 11, 1941 in the District Court, duly captioned in this proceeding, seems too obvious to require citation of authority. However, the recent case of *Cowan v. Tipton, et al.,* 1 Fed. Rules Dec. 694 (D. C. E. D. Tenn. S. D., March 21, 1941), is directly in point. In this case, one Mary Lee Moore, not previously a party to the action, had filed therein an answer and cross-complaint without complying with Rule 24 of the Rules of Civil Procedure for the District Courts of the United States. Motions to dismiss and to strike this answer and cross-complaint were granted. The court said:

> "From the record it appears that Mary Lee Moore is not one of the original parties and that she seeks to become an intervening party by simply filing an answer and a cross-complaint.
>
> No order of the court has been had or sought to make her an intervening party.

> Under Rule 24 of the Rules of Civil Procedure for the United States District Courts, 28 U. S. C. A. following Sec. 723(c), there are very plain provisions as to the conditions under which a person may become an intervening party and very plain provisions as to the procedure necessary to obtain the permission to become such party."

and later in its opinion the court said:

> "It is plain that a person cannot become an intervening party on his own motion. This is true whether his right to become such party is conditional or unconditional. It is for the court to determine this question after reviewing the facts as reflected in the motion and in the pleadings accompanying the motion.
>
> Mary Lee Moore has not complied with the Rule in any respect and her answer and cross-complaint have no place in the record."

It may not be amiss to here anticipate, and answer, the possible contention of the individual appellees that, irrespective of their failure to properly intervene in the Hendy reorganization proceeding, the Hendy Co. was nevertheless a proper party thereto and, accordingly, that the petitions of February 19 and March 11, 1941 were properly filed on its behalf. However, even assuming (but not conceding) that the reorganization proceeding was still open at the time these petitions were filed, such a contention is without merit. The Shores and Behneman State Court actions against which these petitions were directed in no way affect the Hendy Co., its property or its creditors.

The corporate stock of the Hendy Co., not its corporate assets, is the subject matter in controversy in these State Court actions. It is true that the company is joined as a nominal defendant in these State Court actions, but these actions are actually brought in its behalf and for its benefit and the benefit of all of its stockholders, other than appellees Bassick, Hyland and Levit as distributees of the stock in question. Through these State Court actions relief is sought only *against the individual appellees, as defendants therein,* and they are the only ones who could be *adversely affected* by a decision favorable to the plaintiffs in these actions. In other words, the controversy to be determined by the State Court declaratory relief actions centers entirely around the Hendy stock distributed to appellees Bassick, Hyland and Levit, and only the propriety of this stock distribution is in dispute between the individual parties to these actions, that is to say, the old Hendy stockholders on the one hand and the Hendy Directors and managing officers on the other. The District Court accordingly erred in denying appellants' motion to dismiss appellees' February 19 and March 11, 1941 petitions by reason of their failure to properly intervene in the Hendy reorganization proceeding.

3. THE DISTRICT COURT HAD NO JURISDICTION OVER THE SUBJECT MATTER INVOLVED IN THE SHORES ACTION AS PRESENTED BY APPELLANT SHORES' COMPLAINT FILED THEREIN. NO "FEDERAL QUESTION" IS PRESENTED BY THE FACTS ALLEGED IN THIS COMPLAINT, AND ITS REMOVAL FROM THE STATE COURT WHERE ORIGINALLY COMMENCED, AND WHERE JURISDICTION HAD ATTACHED, WAS THEREFORE IMPROPER.

The allegations of the complaint in the Shores action, originally filed in the State Court, have already been summarized and the character of the relief sought therein has been described. As previously pointed out, this action was removed to the District Court upon the petition of defendants therein (appellees here), and appellant Shores' motion in the District Court to remand the action to the State Court was denied. (Transcript, page 47.) The order overruling this motion to remand was not a final judgment on the merits, and it is well settled that a ruling on a motion to remand a cause from a Federal to a State Court is reviewable on appeal from final judgment. (*Morgan v. Kroger Grocery & Baking Co.*, 96 Fed. (2d) 470, C. C. A. 8th Cir., 1938.) To this effect also see:

Lockhart v. New York Life Ins. Co., 71 Fed. (2d) 684 (C. C. A. 4th Cir. 1934);

Thomas v. Great Northern Ry. Co., 147 Fed. 83 (C. C. A. 9th Cir.);

Bender v. Pennsylvania Co., 148 U. S. 502, 37 L. Ed. 537.

The general appearance by appellant Shores in the District Court after removal of her action from the State Court and denial of her motion to remand did not waive her objection to the jurisdiction of the Dis-

trict Court founded on a total lack of any controversy of a Federal nature. (*In re Winn,* 53 L. Ed. 873, 213 U. S. 457; *Pepper v. Rogers,* 128 Fed. 987.) In fact, as stated in *Schell v. Food Machinery Corp.,* 87 Fed. (2d) 385 at 387 (C. C. A. 5th Cir. 1937):

> "The question of Federal jurisdiction is ever present and self-asserting. The court must of its own motion and even against the consent or the protest of the parties consider it."

As will appear from appellees' removal petition (Transcript, page 31), the sole ground urged in removing the Shores action from the State to the Federal Court was that it involves a "federal question". In other words, in invoking the jurisdiction of the District Court it was and is contended by appellees that this action is one "arising under the Constitution or laws of the United States" within the meaning of the so-called removal statute. (*Judicial Code* Sec. 28, *U. S. C.* Title 28, Sec. 71.) Therefore, unless the complaint in the Shores action presents a *federal question,* that is to say, unless under the allegations thereof the case presented is one which *arises under the Constitution or laws of the United States,* then the District Court erred in denying appellants' motion to remand the same to the State Court.

A case arises under the laws of the United States only when a recovery depends upon the construction of such a law, and if a bona fide dispute concerning such laws does not exist, a Federal Court does not have jurisdiction. This is the settled rule.

> *Spencer v. Duplan Silk Co.* (Pa. 1903), 191 U. S. 526, 48 L. Ed. 287;

Little York Gold-Washing etc. Co. v. Keyes (Cal. 1878), 96 U. S. 199, 24 L. Ed. 656;

California Oil. etc. Co. v. Miller (C. C. Cal. 1899), 96 Fed. 12;

Cuyahoga River Power Co. v. Northern Ohio etc. Co. (Ohio 1920), 252 U. S. 389, 64 L. Ed. 626;

Ford Brothers & Co. v. Eddington Distilling Co. (D. C. M. D. Penn. 1939), 30 Fed. Sup. 213;

Wilson v. Robinson (C. C. A. 9th Cir.), 16 Fed. (2d) 431, Certiorari denied, 275 U. S. 526, 72 L. Ed. 407;

Gustason v. Cal. Trust Co. (C. C. A. 9th Cir.), 73 Fed. (2d) 765;

Marshall v. Desert Prop. Co. (C. C. A. 9th Cir. 1939), 103 Fed. (2d) 551, Certiorari denied, 84 L. Ed. 473, 308 U. S. 563;

1 *Cyc. Fed. Proc.* 853, Sec. 184;

Blackburn v. Portland Gold Mining Co., 175 U. S. 571, 44 L. Ed. 276 at 281.

The test of what constitutes a case arising under the laws of the United States was stated by this Court in *Wilson v. Robinson, supra,* as follows:

> "The only ground upon which the plaintiff seeks to predicate federal jurisdiction is that the case arises under the laws of the United States. It is familiar knowledge that, to bring a case within this branch of jurisdiction, it must affirmatively and distinctly appear from the averments of the pleading that 'it really and substantially involves a dispute or controversy respecting the validity,

construction, or effect of' a federal law, 'upon the determination of which the result depends'."

Whether a case is removable as one arising under the laws of the United States depends entirely upon, and is to be determined by, the allegations of plaintiff's declaration or complaint.

American Well Works v. Layne & Bowler Co., 241 U. S. 257, 60 L. Ed. 987;

Great Northern Ry. Co. v. Alexander, 246 U. S. 276, 62 L. Ed. 713;

Mosher v. City of Phoenix, 287 U. S. 29, 77 L. Ed. 148;

Wilson v. Robinson, supra;

25 *C. J.* 767, Federal Courts, Sec. 78.

This is true irrespective of the facts developed on the trial in the Federal Court or the decision on the merits.

Pac. Electric Ry. Co. v. Los Angeles, 194 U. S. 112, 48 L. Ed. 896, 899;

Mosher v. City of Phoenix, supra.

If on the face of the complaint or petition a case is not removable, it cannot be made removable by any statement in the petition for removal or in subsequent pleadings by the defendant.

Great Northern Ry. Co. v. Alexander, supra.

Upon application of the foregoing rules and tests to the complaint in the Shores action (Transcript, page 3), it becomes apparent that the same does not present a *federal question* within the recognized and well defined meaning of that term. The facts therein

alleged do not involve a dispute or controversy respecting the validity, construction or effect of any Federal law. The Shores action merely involves a determination of the property rights of the parties thereto with respect to stock of the Hendy Co. in question, which rights were established by, and rise out of, the Hendy Plan of Reorganization and decree of the District Court confirming it. Those rights can only be determined in the light of events occurring since the conclusion of the reorganization proceeding in the District Court. Such determination may incidentally involve the interpretation and construction of the Hendy Plan, with particular reference to the meaning of the term *"successful rehabilitation"* as used in Paragraph 6G 2 of said Plan. But neither the Constitution nor laws of the United States can afford any aid in the solution of this problem. It is simply a question of law to be determined by well settled rules of construction, rules which a State Court may apply with perfect propriety, as previously pointed out in this brief. A suit to enforce a property right acquired under the authority of judgments and decrees of a Federal Court may be maintained without presenting any question involving the laws of the United States. Such a suit is not necessarily one *arising under the Constitution or laws of the United States* within the meaning of the removal statute. This is clearly recognized in *Carson v. Dunham,* 121 U. S. 421, 30 L. Ed. 992 at 994, where the court, in quoting from *Provident Sav. etc. Society v. Ford,* 114 U. S. 635, 29 L. Ed. 261 said:

> "* * * a suit on such a judgment is 'simply the case of an ordinary right of property sought to be enforced', unless some question is raised 'distinctly involving the laws of the United States'."

The case of *United States ex rel. State of North Carolina, et al. v. Douglas* (Supreme Court of N. C. 1893), 113 N. C. 190, 18 S. E. 202, 203, is in point. This was a civil action brought in the Superior Court of Wake County, North Carolina, against the sureties on the bond of a receiver appointed in the Federal Circuit Court for the Eastern District of North Carolina. Defendant Douglas petitioned to remove the case to said Federal Circuit Court upon the ground that a federal question was involved, namely, that under the complaint the construction of the receivership bond and certain decrees and orders of the Federal court referring thereto was presented. In denying this removal petition, the Supreme Court of North Carolina said:

> "There is nothing to show that any question of construction of these decrees and orders, other than the necessity to interpret them according to their plain meaning, will arise. If the act should receive the wide interpretation claimed for it by the petitioner, no cause could be tried in the state court if objection were raised by the defendant, where any right had been formerly determined in a federal court as a discharge in bankruptcy, or where the title to land sold under foreclosure proceedings in such court were necessary to be shown in evidence, or the like. The simple question is whether the defendants are liable upon the bond,

> and to what amount. It is like an 'attempt to enforce an ordinary property right acquired under the authority of judgments and decrees in the courts of the United States, without presenting any question distinctly involving the laws of the United States'. Carson v. Dunham, 121 U. S. 421, 7 Sup. Ct. Rep. 1030."

It is true that in the Shores case appellant Shores seeks the determination of rights which originated out of a Plan of Reorganization formulated under the provisions of former Section 77-B of the National Bankruptcy Act, but such a determination in no sense requires a construction of that law and no controversy exists with reference thereto. As aptly stated by Judge Stephens in *Marshall, et al. v. Desert Properties Co., et al., supra* (103 Fed. (2d) 551 at 552), a case decided in this court:

> "It is well settled that a suit to enforce a right which takes its origin in the laws of the United States is not necessarily, for that reason alone, one arising under those laws, for a suit does not so arise unless it really and substantially involves a dispute or controversy respecting the validity, construction or effect of such law, upon the determination of which the result depends. Gully v. First National Bank, supra. As said by the Supreme Court in Cook County v. Calumet, etc. Canal Co., 138 U. S. 635, 11 S. Ct. 435, 440, 34 L. Ed. 1110, 'The validity of a statute is not drawn in question every time rights claimed under such statute are controverted, nor is the validity of an authority every time an act done by such authority is disputed.' "

Federal Courts do not acquire jurisdiction of a cause merely because a Federal statute must be referred to in order to explain a contract. *Hannum v. New Amsterdam Casualty Co.,* 330 Pa. 353, 199 Atl. 331 (Sup. Ct. Pa. 1938).

For the reasons expressed above, the District Court erred in holding that a "federal question" is presented by the allegations of the Shores complaint, and in denying appellant Shores' motion to remand that action to the State Court.

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4. THE JUDGMENT OF THE DISTRICT COURT ON THE MERITS WAS ERRONEOUS.

The controversy presented by these consolidated causes was created by the distribution to appellees Bassick, Hyland and Levit on December 20, 1940 of 2212½ shares of Hendy stock—the same shares previously surrendered by the old Hendy stockholders under the provisions of Paragraph 6G 2 of the Hendy Plan of Reorganization. This stock was presumably distributed upon the theory that the last mentioned appellees, as managing officers of the Hendy Co., were entitled to it under the provisions of said Paragraph 6G 2. Whether this stock distribution was proper is the fundamental question to be determined by this court in deciding whether the judgment of the District Court was correct *on the merits.* If the judgment is sustained, appellees Bassick, Hyland and Levit, as the owners of the shares in question, will be entitled to participate in the distribution of all future liquidating

dividends declared by the Hendy Co. upon an equal pro rata basis with the old stockholders. If the judgment is reversed, said appellees would be excluded from such participation in so far as the shares in question are concerned, assuming that such reversal were to result in the granting of the relief prayed for in the Shores action.

The propriety of this stock distribution depends upon:

1. A proper construction or interpretation of the meaning and effect of Paragraph 6G 2 of the Hendy Plan, and particularly of the term "successful rehabilitation" as used in said Paragraph; and

2. A determination of whether the affairs of the Hendy Co. had been *successfully rehabilitated* on December 20, 1940 (the date of the stock distribution), in view of events which occurred *after March 24, 1936*—when the Hendy Plan was approved by the District Court with directions that it be put into effect.

Construction of paragraph 6G 2 of the Hendy plan as a whole.

Paragraph 6G 2 of the Hendy Plan is quoted in full on page 17 of this brief. It will be noted that under the provisions of this Paragraph the managing officers of the Hendy Co. were to receive the stock in question "as a reward for management *and* the successful rehabilitation" of the Hendy Co.'s affairs. "Management" and "successful rehabilitation" are used in the conjunctive, and distribution of the stock in ques-

tion can accordingly be justified only in the event that successful rehabilitation was accomplished. It cannot be said that distribution of the stock as a reward for management alone would have been warranted, for the words *successful rehabilitation* would thus be rendered meaningless. This would be inconsistent with well established rules of legal construction.

It is stated in 3 *Cor. Jur. Secundum,* 1068, that:

> "Ordinarily the words 'and' and 'or' are in no sense interchangeable terms, but, on the contrary are used in the structure of language for purposes entirely variant, the former being strictly of a conjunctive the latter of a disjunctive, nature. Nevertheless, in order to effectuate the intention of the parties to an instrument, a testator, or legislature, as the case may be, the word 'and' is sometimes construed to mean 'or'. This construction, however, is never resorted to except for strong reasons and the words should never be so construed unless the context favors the conversion, as where it must be done in order to effectuate the manifest intention of the user, and where not to do so would render the meaning ambiguous, or result in an absurdity, or would be tantamount to a refusal to correct a mistake."

In *Robinson v. Southern Pacific Co.,* 105 Cal. 526, 543, the Supreme Court of California in speaking of the words "and" and "or", stated:

> "Ordinarily they are in no sense interchangeable terms, but, upon the contrary, are used in the structure of language for purposes entirely variant. 'There is a world of difference between the little words "and" and "or".' State v. Beaucleigh, 92 Mo., 497."

For other cases holding that the words "and" and "or" are not interchangeable terms but, on the contrary, are used in the structure of language for purposes entirely variant, see:

City of Corona v. Merriam, 20 Cal. App. 231;
Dickinson Industrial Site Inc. v. Cowen, 309 U. S. 382, 84 L. Ed. 819;
Mayer v. Cook, 57 N. Y. S. 94;
Pitcairn v. American Refrigerator Transit Co., 101 Fed. (2d) 929, 937;
Atlantic Terra Cotta Co. v. Masons' Supply Co., 180 Fed. 332, 338.

Paragraph 6G 2 of the Hendy Plan contemplates the exercise of certain discretion on the part of the Hendy Board of Directors in connection with the distribution of the stock therein referred to. It has been contended by appellees that the language used gave the Board power to determine whether the affairs of the Hendy Co. had been successfully rehabilitated. Appellants submit that under a proper construction of this Paragraph it was not left to the discretion of the Board to determine whether successful rehabilitation had been accomplished. That is a question of fact to be determined after the intended meaning of the term has first been established, and then only upon a review of matters which occurred *after confirmation of the Plan by the District Court.* The only discretion vested in the Board under this Paragraph of the Plan was to decide, *once successful rehabilitation had been accomplished,* whether or not the managing officers were to receive the stock in question, either in whole or in part. In other words, it was not mandatory upon the

Board to distribute the stock to the managing officers, even if successful rehabilitation was accomplished. This is the only construction consistent with the purpose and intent behind this Paragraph and the Hendy Plan as a whole.

If, on the other hand, the view is taken that under a proper construction of Paragraph 6G 2 the Hendy Board was vested with sole discretion in the matter of determining when and under what circumstances the affairs of the Hendy Co. might be considered as successfully rehabilitated, then it is submitted (in view of events which occurred between the confirmation of the Hendy Plan on March 24, 1936 and December 20, 1940), that determination by the Hendy Board on the last mentioned date that successful rehabilitation of the Hendy Co.'s affairs had been accomplished *was a gross abuse of discretion.*

To arrive at the true intent and meaning of Paragraph 6G 2, it is necessary to consider the situation of the Hendy Co. and of the parties affected by the Hendy Plan at the time that it was approved by the District Court. What did each of these parties expect to receive, and what did they all hope to accomplish through adoption and consummation of the Plan? At the time the Plan was proposed, it is undisputed that the Hendy Co. was insolvent and that its then outstanding stock was presumably worthless. However, immediate liquidation would have resulted in substantial loss to creditors and *total loss to stockholders.* Continuation of the business as a going concern was to the best interests of all concerned.

The objectives of the various parties in interest were as follows:

1. The Hendy creditors wanted their money and a continuing customer with which to do business;

2. The Hendy stockholders wanted a liquid and solvent dividend paying business, with the direction of its policies and affairs restored to their hands.

These objectives could only be accomplished through *a successful rehabilitation of the business as a going concern,* and to this end the Hendy Plan provided:

1. Reduction of all existing obligations, both secured and unsecured, and a deferment of maturity of those obligations for a period of five years from March 24, 1936, and thereafter until such extended obligations were fully paid (see Paragraph 6 of the Plan, Transcript, pages 181 to 187);

2. All outstanding stock was called in and 50% thereof was placed in a voting trust, said voting trust to continue for said five-year period; and thereafter until all deferred obligations of the company were fully paid (see Paragraph 6G 1 of the Plan, Transcript, page 186);

3. The other 50% of the then outstanding stock was to be held by the Hendy Board of Directors under the provisions of Paragraph 6G 2 of the Plan now under discussion. (Transcript, page 187.)

The purpose behind every plan of reorganization approved and confirmed under Section 77-B was to (1) primarily protect the interests of the creditors to the end that they might not suffer undue loss through forced sales, and (2) to preserve the going concern value of the corporation by providing a program whereby administration of the affairs of the corporation might eventually, after payment of creditors' claims, be returned to the stockholders. Each such plan was approved and confirmed upon the premise that it was both equitable and feasible, and that it would be the means of *insuring continued life of the corporation.*

Appellants submit that the above mentioned considerations and purposes were uppermost in the mind of the District Court and in the minds of the parties affected by the Hendy Plan of Reorganization at the time it was approved and confirmed on March 24, 1936. This view is supported by the Plan itself, for in Paragraph 8 thereof (Transcript, page 188), under the title "Effect", it is provided that:

> "While this Plan of Reorganization will not expunge any of the liabilities of the debtor corporation by transferring them into capital, it will definitely postpone the payment of both principal and interest receivership obligations * * * for a sufficiently long period *to give the new management an opportunity to resuscitate the debtor corporation,* while at the same time the rate of interest is materially reduced. *The mere deferment of payment does not, of course, satisfy either principal or interest; but it is manifest that the definite postponement of the payment of all interest and*

pre-receivership liabilities for five years (so that, during such period, the debtor corporation will only be required to pay its current operating expenses, taxes, and the small balance of its receivership accounts), will afford the new management a reasonable opportunity for rehabilitation. If the affairs of the debtor corporation cannot be restored within this period, drastic measures, perhaps even abandonment, will be necessary. *If, however, substantial progress is made, any necessary further funding should be readily accomplished."* (Italics ours.)

The intent behind Paragraph 6G 2 must be read in conjunction with Paragraph 8 quoted above, and from the latter paragraph it clearly appears that the primary objective of the Hendy Plan was to resuscitate the debtor company as a going concern. Rehabilitation rather than liquidation and abandonment was to be accomplished, if possible, and the debtor company was afforded not only a full initial five-year moratorium period following March 24, 1936 (the Plan confirmation date) within which to accomplish this result, but such additional time thereafter as might appear necessary. (See Paragraph 6 of the Plan, Transcript, pages 183 to 185; also Transcript, page 630.) From Paragraph 8 it is apparent that abandonment and liquidation was considered as a last alternative, to be resorted to only after the expiration of the first five years and then only if no substantial progress toward rehabilitation had been made.

It will now be in order to review the progress of the Hendy Co. following confirmation of the Plan on

March 24, 1936. That the following events occurred is uncontroverted:

1. Between March 24, 1936 and November 15, 1940, approximately $295,078.40 of the $570,044.97 of deferred obligations to be satisfied under the Plan had been repaid out of earnings, leaving an unpaid balance of approximately $274,966.57 yet unpaid on account of said deferred obligations (Transcript, pages 74, 75, 547, 624);

2. On November 15, 1940, over four months yet remained before the five-year deferment period covering the company's obligations under the Plan would expire, that is to say, said five-year period would not have expired until March 24, 1941 (Transcript, pages 839, 840);

3. On November 15, 1940, the company was not in a cash position to pay said remaining balance of $274,966.57 of deferred obligations (Transcript, page 628);

4. No dividends had been paid or declared in favor of stockholders of the company since confirmation of the Plan on March 24, 1936 (Transcript, page 108);

5. As late as April and July of 1940 (only a few months prior to the Hendy Board's determination of successful rehabilitation on December 20, 1940), Mr. Moores, a member of the Hendy Board and Board representative of The Bank of California, the Hendy Co.'s largest creditor, had rejected the request of appellee Bassick, then President of Hendy Co., that the stock in question here be distributed to the managing officers of the company (Transcript, pages 785, 839, 840);

6. On November 15, 1940, the company's principal and only operating assets, that is to say, its Sunnyvale plant and equipment, were sold to Felix Kahn, assignee for MacDonald & Kahn, Inc., for the sum of $426,000. (Transcript, pages 110, 111.) This sale required an abandonment of the corporate name "The Joshua Hendy Iron Works" (Transcript, page 825) and constituted a sale of capital assets. It is to be noted that in a previous meeting of the Hendy Board held on November 4, 1940, at which the granting of an option to MacDonald & Kahn, Inc., for the purchase of the Sunnyvale plant was voted (Transcript, page 597 et seq.), appellee Bassick, then President and a Director of the Hendy Co., voted in opposition to the granting of the option (Transcript, pages 599 to 602);

7. After said sale, the debtor company retired the remaining $274,966.57 of deferred obligations then unpaid. (Transcript, page 550.) Proceeds of sale of the Hendy plant at Sunnyvale had to be resorted to in order to accomplish this (Transcript, page 630);

8. On November 19, 1940, the Directors of the Hendy Co. amended the Articles of Incorporation of the company, changing the name thereof from "The Joshua Hendy Iron Works" to "Hendy Realization Co." (Transcript, page 550);

9. On December 20, 1940, the Directors of the Hendy Co. by resolution declared the affairs of the company to be *successfully rehabilitated* and at the same time proceeded to distribute to appellees Bassick, Hyland and Levit the 2212½ shares of stock here in question, presumably pursuant to Paragraph 6G 2 of

the Hendy Plan (Transcript, pages 112 to 115.) This is the first occasion on which the Hendy Directors had taken any formal action to declare that the affairs of the company had been *successfully rehabilitated* (Transcript, page 621);

10. On December 21, 1940, proceedings were initiated by the Hendy Directors for the voluntary winding up and dissolution of the Hendy Co. (Transcript, page 119.) These dissolution proceedings are still pending at this date.

It is upon these facts that the question of the Hendy Co.'s successful rehabilitation, or lack of it, must be determined.

The word "rehabilitate", according to *Webster's New International Dictionary, 2d edition, unabridged,* means:

> "To restore to a former state of solvency, efficiency, or the like; as to rehabilitate a company financially."

The word "rehabilitation" has not frequently been the subject of judicial definition. However, in *New York Title & Mortgage Co. v. Freedman,* 276 N. Y. S. 72 at 74, the court said:

> " 'Dissolution' of a corporation is the termination of its corporate existence in any manner, whether by expiration of the charter, decree of court, act of the legislature, etc. Cyc. L. Dict. (2d) p. 318. It becomes civiliter mortuus. 'Liquidation' of a corporation implies the winding up of the affairs of the corporation and settlement with creditors (citing cases). Both involve, imply, intend and contemplate the end of the corporate existence.

> On the other hand, *'rehabilitation' involves, implies, intends and contemplates the continuance of the corporate life and activities, and is the effort to restore and reinstate the corporation to its former condition of successful operation and solvency.* See Rehabilitation, Funk & Wagnall's Desk Standard Dictionary (Ed. 1927) p. 656." (Italics ours.)

In *In re Coleman* (D. C. Ky. 1936), 21 Fed. Sup. 923 at 924, the court said:

> " 'Rehabilitation' has not found its way into law cases so frequently as 'liquidation', but it has a well defined meaning of little variety. It means to invest or clothe again with some right, authority or dignity; to restore to a former capacity; to reinstate; to qualify again."

In the light of the facts related above, can it in all fairness be said that the affairs of the Hendy Co. had been *successfully rehabilitated* on December 20, 1940 within the meaning of the Hendy Plan, as determined by the Hendy Board on that date? We think not. Prior to December 20, 1940, the Hendy name, the Hendy manufacturing plant and all other of its corporate capital assets had been sold, dissolution proceedings had been commenced, and the going concern value of the company had thus, for all time, been destroyed. Proceeds of this sale had to be resorted to in order to repay deferred liabilities of $274,966.57 then outstanding. The primary purpose of the Hendy Plan—successful rehabilitation—was therefore defeated, not accomplished, and all possibility of accomplishment was definitely eliminated. Under these

circumstances, it necessarily follows that distribution of the Hendy stock in question to the defendant managing officers was unwarranted, illegal and void.

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5. **THE INJUNCTIVE RELIEF GRANTED APPELLEES EXCEEDS THE ISSUES RAISED IN THESE CONSOLIDATED PROCEEDINGS.**

Irrespective of the questions heretofore raised in this brief regarding the jurisdiction of the District Court and regarding the propriety of its judgment entered herein on the merits, the scope of the injunctive relief granted appellees under said judgment is too broad and goes far beyond any of the issues raised by the pleadings and the relief prayed for by appellees in their petitions of February 19 and March 11, 1941. These consolidated causes deal solely and exclusively with the propriety of the distribution to appellees Bassick, Hyland and Levit on December 20, 1940 of 2212½ shares of Hendy stock, as previously discussed in this brief. Under said petitions of February 19 and March 11, 1941, appellees sought only to have appellants permanently enjoined from further prosecuting the State Court actions therein specifically described (and already discussed in this brief), it being claimed that these actions constituted attempted interferences with various orders and decrees of the District Court in the old Hendy reorganization proceeding.

A determination of the propriety or impropriety of the salaries, bonuses and cash paid by appellee Hendy Realization Co. to appellees Bassick, Hyland and

Levit between March 24, 1936 (the Hendy Plan confirmation date) and November 15, 1940 (the date of sale of the Hendy assets) is not prayed for by any party to these consolidated causes, and is not in any way involved here. This was conceded by Mr. Ferguson, one of appellees' counsel, in his opening statement to the District Court at the commencement of the trial. Mr. Ferguson stated:

> "Now, the cash distribution is not here involved. The only thing involved is the stock." (Transcript, page 525.)

Yet under Consolidated Findings of Fact Nos. XI (Transcript, page 108), XII (Transcript, page 109) and XVI (Transcript, page 118), and under Consolidated Conclusion of Law No. 3 (Transcript, page 128), the District Court has found and concluded as a matter of law not only that this stock distribution was proper, but likewise that certain salaries, bonuses and cash distributions to appellees Bassick, Hyland and Levit were likewise proper, and in the judgment of November 15, 1941 appellant Shores and Behneman are restrained and enjoined from "* * * taking or doing any and all acts and/or from the commencement or continuation of any and all proceedings interfering with or attacking the order of the above entitled court dated March 24, 1936, or the enforcement thereof, and/or the distribution of 2212½ shares of the capital stock of Hendy Realization Co., to the managing officers of said corporation pursuant thereto and/or the rights of petitioners and defendants W. R. Bassick, E. M. Hyland, and Morris Levit, the distributees of

said capital stock *and/or the distribution of salaries, bonuses, and cash to petitioners and defendants W. R. Bassick, Elmer M. Hyland, and Morris Levit* * * *" (Italics ours.) (Transcript, page 135.)

It will be noted from the italicized portion of the above quoted language of the judgment that appellants are now forbidden from commencing *or continuing* any proceedings attacking the payment of said salaries, bonuses and cash to appellees Bassick, Hyland and Levit, yet it is clear from the record that this prohibition is improper and unwarranted, and goes far beyond the issues presented in these consolidated causes, as pointed out above. There is presently pending in the State Court an action entitled "Behneman, et al. v. Hendy Realization Co., et al.", San Francisco Superior Court No. 303,651 (not previously discussed in this brief), through which the sole question of the propriety of said bonus and cash payments to appellees Bassick, Hyland and Levit, as well as to certain other employees not parties to these proceedings, is directly presented. In that action, which was commenced on July 18, 1941, only approximately two months before the trial of these consolidated causes, the same individual appellees in these proceedings are named as defendants. The pendency of this State Court action was recognized and referred to by appellees' counsel at the time of trial, and it was conceded at that time that the cash and bonus distribution issue was involved only in said State Court action, and not here. Mr. Ferguson, of appellees' counsel, after making the statement quoted above, continued as follows:

"These same counsel and these same parties have filed another action in the State Court involving the cash distribution, so it is not here before your Honor. We think they all should be here, but it was recently filed, it is not at issue. The question might be determined here, but the fact is that cash distribution is not here involved. *The sole question is the distribution of that stock.*" (Transcript, pages 525, 526.)

At another point during the trial when evidence was offered by appellants regarding these cash distributions made by the Hendy Directors to appellees Bassick, Hyland and Levit on December 4, 1940—this only for the purpose of showing the cash position of the Hendy Co. at that time—the following colloquy occurred between court and counsel:

"Mr. Jordan. Will you stipulate that at a meeting of the board of directors of the company held on December 4, 1940, additional compensation for the year 1940 was voted to the defendants, Bassick, Hyland and Levit in the following amounts: Mr. Bassick, $40,000; Mr. Hyland, $20,000; Mr. Levit $20,000?

Mr. Ferguson. No, I won't so stipulate. That was not the fact. The fact was, and the resolution shows that that was voted to them, not for 1940, but for the entire time from the time of reorganization, from March, 1936, and the resolution so shows.

Mr. Jordan. I propose to introduce that resolution later, Mr. Ferguson, and in any event it will speak for itself.

The Court. If you have it why don't you introduce it now?

Mr. Jordan. I am about to read, if counsel permits, from the sworn answer to interrogatories propounded by respondents Behneman and Shores in this matter some time ago.

The Court. I am wondering if the record is not here.

Mr. Jordan. I am perfectly willing to read it from the minute book. I assume that these, having been prepared by counsel, would be correct.

Mr. Ferguson. That is an exact copy. I would like to inquire what the purpose of this line of inquiry is, because these payments are not involved in this case. Counsel has another suit, as I stated, pending in the State Court.

Mr. Jordan. I believe that the court will be interested in knowing exactly what became of the proceeds of the sale of the plant, and I propose to connect this later on by showing that the only way that they could have paid $300,000 on December 4, 1940, was by resorting to the proceeds of the sale of the plant; in other words, a sale of the capital assets. This money did not come out of earnings; it could not have, because they did not have enough on hand to pay it. We expect to prove they dipped into the proceeds of the sale of the plant to pay off $274,000 odd that they still owed under the provisions of the plan which were to entirely mature in a matter of four or five months. Therefore, I think it is highly material to the court, and your Honor so ruled when you overruled the objections to that interrogatory.

The Court. Do you make that as an objection?

Mr. Ferguson. I object, in the first place, to this line of inquiry on the ground that the bonuses are not here involved. We have no desire to deprive the court of all the facts, but we must not

try other cases with this case. The second point is, this claim is going to involve an accounting of that year to determine where the money came from to pay that.

The Court. How are you going to ascertain that without examining the books?

Mr. Jordan. I believe that I can establish by evidence that if the proceeds of the sale of their particular assets had not come into the company it would have been impossible for them to have declared a bonus or additional sums of $103,000 and at the same time, within a matter of days, also paid off all the remaining obligations under their plan of reorganization.

The Court. I will overrule the objection. You are now going to read from the answer to the interrogatories." (Transcript, pages 550 to 553.)

It is clear from the foregoing statements of the court and counsel that evidence regarding the additional compensation payments made to appellees Bassick, Hyland and Levit on December 4, 1940 was offered, and admitted, for the limited purpose of showing that in December of 1940 the Hendy Co. could only have made cash disbursements aggregating over $375,000 (inclusive of deferred obligation and additional compensation payments) by resorting to the proceeds of sale of the capital assets of the company. Obviously, this evidence was neither offered nor admitted for the purpose of determining the propriety or impropriety of said additional compensation payments.

The reason for appellees desiring the insertion of the broad language of the judgment quoted and italicized above is, of course, understandable and obvious.

If permitted to stand, said language is so broad that the further prosecution of the last mentioned State Court action will be forever barred. By the same token, appellants herein, as plaintiffs in said State Court action, will be deprived of their right to a judicial determination of the issues there presented—issues admittedly in no way involved in these consolidated causes. It is accordingly submitted that, irrespective of the ruling of this court on the other matters raised by this appeal, the italicized portion of the above quoted language of the judgment entered herein should be deleted, to the end that appellants may be free to prosecute said State Court action involving the propriety of said bonus and cash payments to a final determination on the merits.

CONCLUSION.

From the facts and arguments stated above, and in view of the authorities cited, appellants draw the following conclusions:

1. That the District Court had no jurisdiction over the subject matter of the petitions filed by appellees in the old Hendy reorganization proceeding on February 19 and March 11, 1941, and accordingly erred in denying appellants' motion to dismiss the same; and that the District Court likewise erred in denying appellants' motion to dismiss said petitions for the reason that the individual petitioners, appellees herein, failed to properly intervene in said Hendy reorganization proceeding;

2. That the District Court had no jurisdiction over the subject matter of the Shores action, there being no "federal question" there involved, and accordingly erred in denying appellant Shores' motion to remand said action to the State Court from which it was removed;

3. That the District Court erred in finding and decreeing on the merits of these consolidated causes that the affairs of the Hendy Co. had been successfully rehabilitated on December 20, 1940, and that the 2212½ shares of Hendy stock here in question were properly distributed to appellees Bassick, Hyland and Levit;

4. That the propriety or impropriety of the bonus and cash payments made by the Hendy Co. to appellees Bassick, Hyland and Levit between March 24, 1936 and December 20, 1940 is not an issue in these consolidated causes and, accordingly, that the District Court erred in including in the permanent injunction entered herein that portion thereof restraining appellants from the commencement or continuation of any proceedings attacking the payment of said bonuses and cash.

Appellants accordingly submit that the judgment of the District Court should be reversed.

Dated, San Francisco, California,
August 19, 1942.

Respectfully submitted,
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